POSITION AND POLICY STATEMENT ON ENHANCING THE ALBERTA CAPITAL MARKET

Policy Statement #2
In response to the White Paper:
An Industrial and Science Strategy for Albertans
1985 - 1990

Alberta
GOVERNMENT OF ALBERTA
September, 1985

LEGISLATIVE ASSEMBLY
ALBERTA

R. KEITH ALEXANDER, M.L.A.
EDMONTON WHITEMUD CONSTITUENCY

202 Legislature Building
Edmonton, Alberta T5K 2B6
Telephone: (403) 427-1862

POSITION AND POLICY STATEMENT

ENHANCING THE ALBERTA CAPITAL MARKET

OCTOBER 1st, 1985.

In July 1984, the Government of Alberta released "Proposals For An Industrial & Science Strategy for Albertans 1985 to 1990", the White Paper, which identified a lack of financial decision-making in the Province of Alberta. The White Paper pointed out particularly the need for additional risk equity capital in our Province.

Responses to the White Paper process led Premier Lougheed to appoint a task force on capital markets which consisted of members in the private and public sectors. The task force drew upon the considerable experience of its members, mostly from the financial industry, in order to determine what ought to be included in the paper and what recommendations, policies and strategies could be made to develop a more functional equity capital market. It is hoped that interested Albertans will study this paper, noting particularly the quote on the title page which sums up the main theme which is to develop a more viable, liquid and accessible equity market.

This statement on capital markets presents policy actions which can be taken by the Government and strategies which can be pursued by private sector and the Government co-operatively. Other strategies are recommended to the private sector which it may pursue as it sees fit.

It is important that we acknowledge the substantial contribution made by private sector members of the Task Force as well as the excellent help from Government people within departments and financial agencies. We are indebted to the following for their contribution to the preparation and production of this paper:

In July 1984, the Government of Alberta released "Proposals for An Industrial & Science Strategy for Albertans 1985 to 1990", the White Paper, which identified a lack of financial decision-making in the Province of Alberta. The White Paper pointed out particularly the need for additional risk equity capital in our Province.

Responses to the White Paper process led Premier Lougheed to appoint a task force on capital markets which consisted of members in the private and public sectors. The task force drew upon the considerable experience of its members, mostly from the financial industry, in order to determine what might to be included in the paper and what recommendations, policies and strategies could be made to develop a more functional equity capital market. It is hoped that interested Albertans will study this paper, noting particularly the quote on the title page which sums up the main theme which is to develop a more viable, liquid and accessible equity market.

This statement on capital markets presents policy actions which can be taken by the Government and strategies which can be pursued by private sector and the Government co-operatively. Other strategies are recommended to the private sector which it may pursue as it sees fit.

It is important that we acknowledge the substantial contribution made by private sector members of the Task Force as well as the excellent help from Government people within departments and financial agencies. We are indebted to the following for their contribution to the preparation and production of this paper:

Minister	Honourable Lou Hyndman Provincial Treasurer
Private Sector Members	Mr. Bernard Davies, Lawyer Wolff Davies, Edmonton.
	Mr. Robert Gray, Resident Manager Richardson Greenshields, Edmonton.
	Mr. Andrew Hyslop, Managing Partner The Merbanco Group, Calgary.
	Mr. Jim Milliken, President Alberta Stock Exchange, Calgary.
	Mr. Mike Prew, Vice President Yorkton Securities Inc., Calgary.
	Dr. Brian Scarfe, Head, Department of Economics University of Alberta, Edmonton.
	Dr. Seha M. Tinic Faculty of Business University of Alberta, Edmonton.
Government Resource Members	Mr. Jim Drinkwater, Assistant Deputy Provincial Treasurer, Finance Programs.
	Mr. Elmer Leahy, Assistant Superintendent Treasury Branches, Central Division.
	Mr. Roy Parker, Managing Director Alberta Opportunity Company, Ponoka.
	Mr. William Pidruchney, Chairman Alberta Securities Commission, Edmonton.
Assistants	Miss Shelley Germann, Director, Industrial/ Financial Sector, Alberta Economic Development.
	Mr. Tom Bateman, Legislative Intern.

We would welcome any suggestions as to implementation of these capital markets strategies, policies and directions.

R. Keith Alexander
M.L.A., Edmonton Whitemud
Chairman, Capital Markets Position & Policy Statement.

Position and Policy Statement:

ENHANCING THE ALBERTA CAPITAL MARKET

"The biggest problem is access to a viable, credible and liquid equity capital market. Such a market need not be Alberta bound but the expansion of Alberta's internal ability to provide an equity capital base would be useful."

INDEX

ENHANCING THE ALBERTA CAPITAL MARKET

I. Policies and Strategies

The White Paper made a number of proposals among which was the encouragement of greater availability of risk equity funds to meet overall capital needs.

This proposal recognized the need for maintaining an economic environment which is conducive to investment. While Canada has a generally efficient national capital market, there is recognition of weaknesses at the regional level. There remains a shortage of Alberta-controlled, risk-taking capital. This paper addresses the problem.

The objective of this paper was succinctly stated in a presentation to the White Paper forums:

> *The biggest problem is access to a viable, credible and liquid equity capital market. Such a market need not be Alberta bound but the expansion of Alberta's internal ability to provide an equity capital base would be useful.*[1]

Another submission to the White Paper process underlined the importance of government money managers and other financial institutions using the services of our financial sector to enable it to expand and strengthen:

> *The key to a viable financial infrastructure can be summed up in two words: Use it.*[2]

Building a financial infrastructure and attracting the financial decision-makers to Alberta are important objectives of the policies and strategies which follow. When these are added to the continuing effort to enhance the quality of life in Alberta, the objective of a more fully integrated community of key decision-makers becomes achievable.

A. **Treasury Branches**

1. Treasury Branches should be self-sustaining and market-oriented, but should not rely on their unique status as crown-owned institutions for their rationale. While they are unique, regional and fulfill special roles, they should compete with banks as much as possible.
2. Treasury Branches' expanded role in international banking accommodation should be commended and pursued as a valuable service to clients. International guarantees should be provided only as required, when no alternative exists, and within the constraints commercially applicable to such guarantees.
3. Treasury Branches should continue to diversify their services commensurate with those of banks, in profitable locations and in locations not well served by banks.
4. Treasury Branches should remain Albertan and not attempt to become national institutions such as the major Canadian banks.
5. Treasury Branches should continue to expand their policy of accommodation to clients in cyclical downturns. This may include such measures as conversion of some debt to equity, extending amortization periods, workouts and other measures which are economically viable through a full business cycle.

B. **Regional Banks**

6. Regional banks will continue to be important instruments of economic development policy. Alberta banks are subject to the disciplines of the marketplace which are applicable to other banks. Over-concentration in loan portfolios has proved to be a problem and should be avoided in the future.
7. Alberta Treasury and other Government money managers should continue to support the Alberta banks with appropriate deposits and should use the expertise of local banks, much as they do the national banks, where specialized financial services are required.

---

1. Dr. Brian Scarfe, Department of Economics, University of Alberta, Submission to the White Paper Forum, September, 1984.
2. Robert Splane, Bank of Alberta, Submission to the White Paper Public Forum, September, 1984.

C. **Investment Dealers and Brokers**

8. Syndicates of Alberta brokers should be formed to sell small issues to the investing public. These small Alberta issues can be successful if more widely supported with patient and risk capital. Alberta financial institutions should support quality junior issues.
9. Syndications of junior issues should be actively encouraged by the Alberta Stock Exchange. Support of such issues will expedite listing and trading on the Alberta Stock Exchange.
10. Alberta-based brokers could attract more capital for financing of equity transactions if a more stable and liquid market environment could be developed.

D. **Alberta Stock Exchange** (ASE)

11. With improvements in share volume and liquidity, a good portion of the trading of Alberta-based corporations could be attracted to the ASE.
12. In order to help develop the ASE as a more viable marketplace in Alberta, the Government of Alberta should lend support by trading more of its own securities on the ASE.

E. **The Alberta Securities Commission** (ASC)

13. In order to reduce the cost to smaller issuers and to speed up the time for clearance of issues, an Exchange Offering Prospectus (EOP) system by which a prospectus is cleared and a listing application approved at the same time, should be introduced in cooperation with the ASE. The EOP system should be made available to smaller issuers.
14. A shorter form prospectus than is presently required should be developed for smaller issuers to allow greater speed of clearance and reduced costs.
15. The **Alberta Securities Act** should be amended to accommodate the small issuer in terms of frequency of reporting by the filing of annual and interim financial statements. The timing requirement for audited financial reports should be 180 days from the end of the fiscal year. One unaudited interim financial report per year should be required 180 days from the filing of the annual financial report.
16. A directorship responsible for the regulation of all financial institutions within Alberta's jurisdiction should be created under one Government department. This includes the transfer of the ASC regulation function. To pursue this proposal, a study will immediately be commenced on the structure of the overall regulation of financial institutions in Alberta. This takes into consideration a previous recommendation of the Alberta Securities Commission.

F. **Alberta Heritage Savings Trust Fund** (Heritage Fund)

17. Investment management of some portion of the marketable securities of the various Government investment funds could be privatized, with overall responsibility remaining with the Legislature.
18. The Heritage Fund management should consider extending further the scope of its equity portfolios to include selected Alberta junior issues. This need not be a large amount, but the presence of the Alberta Treasury and the additional equity funds would improve credibility and liquidity of Alberta Stock Exchange issues.
19. Alberta Treasury investment managers should expand their dealings with local brokers and local branches of national firms, instead of with Toronto trading desks. This would build Alberta-based financial expertise at little or no cost to the Government.
20. If Alberta Treasury required more of its own stock transactions to be done on the ASE, other venture companies, as well as private sector counsellors and fund managers, would be drawn to the Alberta market. Alberta-based brokers need some institutional support to help build the viability of the Alberta Stock Exchange. There already exists a readiness among private investors to participate in a functional equity market and some support from institutions would add to liquidity.

G. **International Trade Loan Guarantees**

21. The Government should continue with its market sensitive, export incentives program of guarantees to exporters when required, but the risk and cost of guarantees should be noted.

H. **Financial Institution Guarantees**

22. Efforts should be directed towards a deposit insurance scheme which enables all financial institutions to participate in a public-private insurance plan along the lines of the Canada Deposit Insurance Corporation. The insurance premiums charged to the members of the plan should reflect the characteristics of the participating financial institutions. The plan could be run by private insurers with participation by Alberta if necessary. This would reduce the requirement for guarantees of individual financial institutions.

I. **Alberta Stock Savings Plan** (ASSP)

23. Many White Paper submissions suggested establishment of an Alberta Stock Savings Plan (ASSP). This provincially-registered plan would provide tax incentives to individuals investing in companies incorporated in Alberta and Canada and would be operated on the Alberta Stock Exchange and through Alberta brokers to add strength to our equity market.

24. The ASSP should have a sunset clause to compel review of its effectiveness in stimulating the provision of equity capital for small business in Alberta. If the ASSP begins in January, 1986 it will expire in December, 1990 unless continued by legislative action.

J. **Education**

25. A Social Studies curriculum in secondary schools (junior and senior high) should include education about Alberta's economy, including an understanding of a functioning model of the Alberta economy, especially in terms of: financial infrastructure; the impact of governments' policies; the role of financial and credit institutions; the role of equity and debt and the tax system.

26. The province's school systems should encourage co-curricular activities such as Junior Achievement, investment clubs, student-operated credit unions, etc.

27. Professional development for teachers, such as the Teacher Internship in Business project, should improve teachers' direct experience with economic enterprises in ways that encourage widespread communication about positive experiences.

II. Introduction

In July, 1984, the Alberta Government initiated what has emerged as the White Paper process. The release of the White Paper, **Proposals for an Industrial and Science Strategy for Albertans: 1985 - 1990,** came as a result of the Government's realization that it was time to reassess the existing industrial strategy and to consider the need for an updated and integrated version.

The Government has encouraged responses to the White Paper by individuals, organizations, and interest groups. A steering committee was formed in September, 1984 to travel the province and receive written and oral submissions on the White Paper proposals. As well, Government MLAs held public forums in their constituencies to discuss the White Paper and its potential impact on Alberta.

The oral presentations and written submissions on the topic of capital markets and the financial infrastructure have been both numerous and helpful. They have illustrated to the Government the importance the private sector attaches to the growth of equity capital pools in Alberta and they have suggested several policies the Government may pursue to realize this objective.

Submissions to the steering committee have been carefully studied in the light of the proposals derived from the White Paper process. These contributions have been of great assistance in preparing this Government's position and policy statement on various sectors of the economy. This position and policy statement, **Enhancing the Alberta Capital Market,** includes many direct quotes from the submissions made by Alberta individuals and organizations.

The purpose of this paper is to focus on the solutions to the problems identified in the White Paper process. Some of the areas to be addressed are the lack of an equity capital base and access to viable, credible and liquid equity capital market for Alberta businesses. Alberta's equity capital market will be discussed with a view to improving delivery of financial opportunities in Alberta.

Some sections of this paper deal with banking and lending institutions which do not essentially provide equity. It was considered insufficient to treat only equity, since debt plays a significant role in the total financial makeup of business enterprises.

In recent years the topic of debt-to-equity ratios has become highlighted in daily conversations because of the highly leveraged condition of Canadian and Alberta businesses. In addition, the lending institutions have become more involved in equity financing, out of necessity, to refinance debt-laden businesses.

Sections of this paper also touch upon conversion of debt to equity, workout programs, bank and government guarantees of equity and international credit guarantees which have all become elements of any contemporary discussion of equity financing.

III. The Financial Environment

A. Alberta

A significant portion of the input to the White Paper process was devoted to the enhancement of small business in Alberta. The White Paper recognized that this sector of the economy accounts for 90 per cent of the businesses in the province and approximately 80 per cent of new employment. It also recognized that small business forms the cornerstone for diversification of Alberta's economic activity and outlined several methods for supporting the growth of small business.

Financing is a critical issue when discussing the creation and growth of small business. During the years of rapid and unsustainable expansion, businesses relied heavily on debt financing provided by both the major and regional banks.

The result of this heavy accumulation of debt was that corporate balance sheets showed too little equity to survive an economic downturn. Equity financing was not readily available at a reasonable cost when small business needed capital to survive, develop and diversify. The White Paper recognized this crucial fact on page 56:

> *There remains a shortage of Alberta controlled risk-taking capital to fully develop our opportunities. This forces us to be quite dependent upon outside sources of decision-making for the commitment of capital.*

The White Paper suggested several options to support the development of a financial community in Alberta and to encourage Albertans to invest their personal and corporate savings in promising Alberta ventures. This would reduce the dependence of Alberta enterprises on external sources of capital and decision-making and therefore on circumstances and factors over which Alberta has no control.

B. Federal Budget

The Federal budget of May 23, 1985, introduced measures which should have a positive effect on equity formation from 1985 to 1990. Reflecting a substantial change in policy direction from previous Governments, the emphasis should result in significant improvement in Canada's ability to transfer savings to equity. The Federal Government outlined a preference for investment stimulus through:

1. New capital gains treatment, through a lifetime personal capital gains exemption of $500,000 to be introduced over six years. For most individuals this exemption means profits on equity investments would be tax free, likely for at least the next five to ten years and perhaps longer, depending on investment levels and on the success of investment.
2. The expansion of Registered Retirement Savings Plan contribution limits and the new eligibility to invest up to 50 per cent of assets in private Canadian corporations which are at arm's length.
3. Various incentives to stimulate investment in small and medium-sized businesses, such as removing ''hands-on'' government industrial incentives and rewarding market-oriented action by lowering the basic federal tax rate.

While not a budget item, retaining preferred share dividend treatment and allowing preferred shares to qualify for the capital gains exemption is also a positive equity stimulus.

The stimulation arising from improved tax treatment of equity investments, contemplated as strategies in Alberta's White Paper, will create a more favorable equity environment in Canada.

The advantage of an investment stimulus approach in the 1985 Federal budget is not immediately calculable for Alberta, but it undoubtedly enhances the Alberta equity market.

As a result of this budget, the contemplation of an Alberta Stock Savings Plan, often proposed by respondents to the White Paper, becomes more driven by individual tax incentives and the development of a profitable Alberta stock market, and less by capital gains considerations.

IV. The Need for Equity Capital

A. The National Problem

Nothing is more important for Canada than channelling savings to the investment process. We need a capital market system that does an efficient job of delivering savings to productive investment, for large and small firms, for regional, national and international firms and for new business. We need investment incentives that transform more savings to true equity capital and less to debt. We need to build confidence and to encourage sensible, intelligent risk-taking by investors. The problem was highlighted by the President of the Investment Dealers' Association (IDA) of Canada:

> *All Canadians should be extremely concerned about the inadequate capital structure of the corporate sector and the weak growth in business investment. Corporations are still carrying too much debt and, along with inadequate capitalization, this has impacted negatively on capital spending. Capital spending is still 19 per cent below the pre-recession peak. Individual Canadians must be encouraged to invest in the growth of business and, in turn, entrepreneurs must be motivated to undertake new job creating capital investments.*[3]

B. Institutionalizing of Savings

The IDA report went on to substantiate the observations of many financial experts that Canada's savings and investment system is falling at an increasing rate into the hands of fewer and larger institutions. The more institutionalized our system, the more savings are invested in debt instruments and less in equity. More funds are committed to larger, more established organizations which are considered safe investments. This results in less savings invested in risk equity, less in small business, regional business and new business.

The propensity to risk taking is lower in an institutionalized and concentrated system than in a decentralized financial system where individual decision making determines investment. If more risk equity is to be available to regional, small and new businesses, incentives must be available to those who make such investments. Increasingly, incentives or enhanced returns must be available to investors to offset the institutionalizing trend in capital markets.

The President of the Investment Dealers' Association of Canada lends support to the Alberta capital market strategy in his opposition to the increased concentration:

> *I do not believe, therefore, that a further institutionalization of our savings and investment process in a decentralized, export reliant and capital intensive country like Canada, is a reasonable or an acceptable strategy for the foreseeable future.*[4]

C. Corporate Undercapitalization

The White Paper identified undercapitalization as one of the chronic problems facing small business in Canada. The need for equity capital is not limited to Alberta but is a national problem.

The weak capital structure of the Canadian corporate sector has caused major corporations to reduce their capital spending programs to cope with and readjust excessive debt burdens. Improved profit levels and cash flow by mid 1985 helped the restructuring process. Equity capital raised through investment dealers, totalling $6.3 billion in 1983 and $5.2 billion for the first nine months of 1984, has been fundamental to this readjustment process and has provided new capital to undertake new productive investment.

Debt-to-equity ratios continue to improve somewhat and, as of mid-year 1984, were 70.4 per cent, down from 79.2 per cent in the fourth quarter of 1982. It is necessary to explore all avenues for improving corporate profitability and attracting savings into equity capital to strengthen balance sheets and increase productive investment.[5]

---

3. Pierre Brunet, "Financial Times of Canada Conference", IDA Report, Winter 1984-85, pg. 2.
4. Ibid, pg. 5.
5. Investment Dealers' Association of Canada.

V. The Alberta Equity Market

A. Equity

The national problem of financing through debt rather than equity has been intensely experienced in Alberta. Speaking of the Alberta situation, the brief from Dr. Brian Scarfe stated:

The biggest problem is access to a viable, credible, and liquid equity capital market. Such a market need not be Alberta bound but the expansion of Alberta's internal ability to provide an equity capital base would be useful.[6]

Such access is accomplished through sophisticated intermediary organizations with specialist knowledge, able to direct individual borrowers to specific sources of funds. Sometimes these funds are located at a great distance and in other currencies. Alberta is lacking in such intermediaries, and is hampered in attracting patient funding to Alberta.

Another submission in response to the White Paper echoed this same concern:

Many corporations within the province are seriously undercapitalized. Many worthwhile and profitable ventures fail to get off the ground for lack of adequate start-up capital.

More importantly, profitable growth is often hampered by lack of additional equity capital.[7]

For new ventures, the important sources of equity are the personal savings of the owners and the investments of families and friends. For this group, protection from losses is as important as long-term profitability.

From the standpoint of growing firms, outside individual investors can bring both capital and know-how to finance growth. However, internally generated funds are the major source of equity financing for small, growing enterprises. A major factor in the creation and growth of small business is access to continuous funding.

B. Decision-makers

Several White Paper submissions went beyond the question of need for equity capital and addressed the problems of supply of equity capital controlled by entities outside the province. The submissions contended that institutions with decision-making centres elsewhere would not sustain a level of commitment acceptable to Alberta when the economy entered periods of adjustment; and would make investment decisions influenced by factors other than, or at least in addition to, those of basic economic merit.

The following remarks are an example of these contentions:

In recent boom times, as noted in the White Paper, extra-provincial financial institutions set up shop within the province to cream off the benefits of a high level of economic activity only to disappear in recessionary times, leaving behind little or no residue of financial skills upon which to build.[8]

The supply of equity capital cannot properly be considered apart from those structures and institutions in which the decisions about capital investment are made. Alberta needs financial institutions which have a commitment to the province extending beyond the periods of economic expansion; and whose decision-making processes with respect to capital funding are not dependent upon decisions made elsewhere. Provincially-based financial institutions know Alberta's opportunities and can act upon local knowledge where national firms must concern themselves with national issues. Any sustained economic growth within the province requires a significant financial infrastructure comprised of a strong regional and national presence.

Financial decision-making requires an environment within which reasonable predictability for risk assessment and thus investment returns are possible. Alberta will continue to provide this environment.

---

6. Dr. Brian Scarfe, Department of Economics, University of Alberta, Submission to the White Paper Forum, September, 1984.
7. The MerBanco Group, Comment on the White Paper: Proposal for an Industrial and Science Strategy for Albertans: 1985-1990, August, 1984, pg. 8.
8. Ibid. pg. 8.

C. Efficient Market Argument

The White Paper committee received an articulate challenge to its assumptions of the need for regional decision-making. One submission from the Department of Economics, University of Alberta, suggested that proceeding on the assumption of market failure in regard to Alberta's underdeveloped capital markets is myopic. The submission noted:

> *. . . the empirical evidence suggests that capital markets are highly efficient and most responsive to differential returns. The lack of risk capital may simply reflect the paucity of profitable opportunities in the province relative to other regions or countries.*[9]

This is a pivotal point, as it casts into question the utility and thus the advisability of Government action to enhance the operation of the Alberta capital market. The proposition presented implies that capital markets in general, and all capital market sectors both national and regional, operate in the same way.

The empirical evidence that suggests that capital markets are highly responsive is from data collected on the national market operation. However, for reasons of size and type of equity investment, a comparative data base for regional markets does not exist. It should also be noted that venture and seed capital markets have less refined data and are more difficult to study quantitatively. One could make the case that any "myopia" seen in the White Paper assumptions is more accurately a lack of visibility, or lack of adequate risk assessment, for risk investors. Any inability to properly assess risk has been aggravated since 1980 by the failed National Energy Program (NEP) and its ongoing region-specific impact. This perception of the problem was also expressed in the White Paper process:

> *We are also aware that our capital markets although pretty efficient by and large in their operation are not always perfect. We are, therefore, supportive of efforts such as the creation of new institutions like an Alberta Innovation Centre which can provide funding to new commercial applications of advanced technology and other ideas.*[10]

The more widely shared perception of Alberta's access to equity capital, particularly for small and innovative businesses, is in this latter presentation. While careful attention must be paid to the efficient capital market argument, there is sufficient evidence that capital markets such as Canada's do not deliver capital with equal efficiency in every market.

In addition, there are times when equity investors perceive safety in purchasing blue chip shares of nationally known companies which offer greater returns and are expected to perform well. These investors most likely have suffered losses through owning regional issues such as junior and intermediate oils and some high technology stocks.

With the gradual return of a more efficient market, the growth of equity investment and an Alberta financial community can be facilitated. As artificial impediments to growth are removed or reduced, the prospects for equity financing of small business can be significantly improved.

Submissions received by the White Paper committee suggested that the regional capital market is not fully integrated with the efficient national market and its operation is hindered by external, policy-created forces. Such forces must be recognized. Governments must examine the nature of policy-induced failures such as the National Energy Program (NEP) when they exist, and determine what should be done to eliminate or neutralize their effects. Equally important is due consideration of normal business cycles which should not be amplified by government action.

---

9. M.L. McMillan, M.B. Percy, L.S. Wilson, Department of Economics, University of Alberta, Submission to the White Paper Forum, September, 1984.
10. Dr. Brian Scarfe, Department of Economics, University of Alberta, Submission to the White Paper Forum, September, 1984.

VI. Alberta Capital Market Infrastructure

A. Introduction

Members of the financial community have contended that any sustained economic growth within the province requires a significant financial infrastructure, much of which is currently missing. This sentiment was echoed in many submissions to the White Paper:

> *A significant weakness of our provincial economy is the lack of financial infrastructure in the province, hence our dependence on outsiders to finance our entrepreneurial innovations. In Alberta, there is a disproportionate lack of decision-makers in financial institutions, life insurance companies, pension funds, investment dealers, and tax syndications. We must attract such a level of decision-maker to Alberta.*[11]

Beginning with financial institutions which are unique to Alberta, it is helpful to survey those which make their decisions to provide capital in Alberta.

B. Treasury Branches

The Treasury Branches are near-banks and play a large role in the supply of banking services to Alberta. Having acquired a comparatively small energy portfolio during the oil boom, the Treasury Branches weathered the recent economic downturn relatively well. Although Treasury Branches are quite popular, no doubt due in part to the silent guarantee of the Provincial Government, they have been criticized for using their special status to undercut competitors.

The Branches are not fully tax exempt. They pay property taxes and other local taxes, pay grants in lieu of taxes, and return a share of surpluses to the Alberta Treasury. Treasury Branches accept deposits and make loans on essentially the same business principles as other banks.

Part of the reason for the Treasury Branches' past success has been their presence in rural areas, filling a vacuum left by other banks and developing a diversified small business lending base.

The Branches are involved in guarantees of clients' international commitments through intermediaries in the United States. This practice is intended to provide Alberta business clients with the credits necessary for access to foreign markets for products or services. Treasury Branches have expanded conservatively to fill some special roles and market gaps, to the apparent satisfaction of most Albertans.

C. Regional Banks

Regional banks continue to be important to Alberta's economic development. Like other regional financial institutions, Alberta-based regional banks had to adjust to falling property values and increases in the number of non-performing loans. Stringent measures have been undertaken by the regional banks to address the effects of recession in an effort to maintain a stable banking sector in Alberta.

Regional banks made attempts to diversify their loan portfolios and sell off non-performing assets, particularly in real estate. To address the high levels of real estate holdings, some banks have established a subsidiary corporation to manage and dispose of properties without disrupting market values. The regional banks have entered the area of merchant banking to diversify income sources while extending their range of service to developing business. They have also sought to increase the percentage of lending activity funded by retail deposits rather than money market borrowing.

11. J.T. Ferguson, Princeton Developments Ltd., White Paper Submission, 1984.

The importance of regional banks was emphasized by the Inspector General of Banks for Canada when he announced in March, 1985 a support package designed "to maintain the Canadian Commercial Bank (CCB) as a force in the Western economy."

Operating in a local or regional economy carries with it the likelihood that bank results will reflect that economy. Thus the CCB experienced large losses in Alberta's economic downturn and required central bank support to sustain public confidence and avoid the consequences that closure would have on Alberta businesses. Unfortunately the efforts of the CCB to recover the confidence of depositors and maintain its viability did not succeed. The CCB was informed on September 1, 1985 that the Bank of Canada would no longer continue to supply deposit replacements to maintain liquidity, and thus the CCB was placed under the supervision of a curator.

Both the CCB and the Northland Bank made attempts at merger discussions which were not successful as they occurred after these banks' assets had seriously depreciated.

The Alberta-based bank closure lends support to a recommendation that more loan syndication should be pursued in order to spread risk among institutions. Cooperation among regional institutions has been suggested as an appropriate response to size and regional disadvantage. The Bank of Alberta commented:

> *In order to foster Alberta's financial infrastructure we believe it is essential that the Bank of Alberta enter into cooperative ventures with other institutions with similar goals.*[12]

The Alberta Government has supported the development of regional banking by holding some of its deposits in several institutions and by maintaining a small equity position in the Bank of Alberta. It has been suggested that Government deposits should continue to be placed in regional banks, thereby allowing them to establish a track record that will eventually attract more wholesale deposits and encourage retail depositors.

> *Government deposits would therefore enhance the ability of Alberta-based financial institutions to grow and meet the credit needs of Alberta.*[13]

As an important part of the Alberta economy, regional banks can contribute to diversification and stability for the future.

D. Investment Dealers and Brokers

Investment dealers are generally confined to securities brokerage, underwriting and corporate finance. Investment dealers play an important part in raising capital for corporations. There are few small provincially-based investment dealer houses, but no national firm has an Alberta base. The Alberta investment brokerage industry consists mainly of the Alberta offices of seventy national and international firms. Most are Canadian-owned, controlled and operated.

These firms form one pillar of the four pillar Canadian financial market (banks, life insurance, trust companies and investment dealers). While the functions of each have been historically separate, the lines are becoming blurred as each tries to expand into other areas of operation. Each is competing for a share of the market for deployment of savings into either debt or equity investment.

As Canada's traditional capital market moves toward greater concentration in the hands of major financial institutions, smaller regional brokers must find new ways to specialize by finding market niches in certain industries or regions. This direction was indicated by the Federal Government's recent Green Paper.[14]

While Alberta has a relatively small number of successful regionally-owned and operated brokerage firms, they have played an important role in the financing of Alberta businesses.

---

12. Robert Splane, Bank of Alberta, Submission to the White Paper Forum, September, 1984.
13. Ibid.
14. The Regulation of Canadian Financial Institutions: Proposals for Discussion, Department of Finance, Canada, April, 1985 (Green Paper).

E. **Alberta Stock Exchange** (ASE)

For over seventy years, the role of the ASE has been to provide the emerging public companies of Alberta with a well-regulated, fair marketplace for the secondary trading of their shares.

There is support for the view that a local exchange can only be justified if it has a role in the raising of share capital for locally-based companies and helps to provide marketability for such issues.

This role of the ASE is not unique. In spite of its duplication by the other Canadian exchanges, the ASE has remained a viable institution. In the last several years, it has earned a respectable reputation within the investment community and has become an accepted voting member on all national investment boards and committees.

Through meetings with the Government and the business leaders of this province, a consensus has developed as to the future role of the ASE in Alberta's development as a viable financial centre for Western Canada. An opportunity exists to expand the Alberta Exchange into a unique marketplace that can provide a specialized access to development or risk capital. This will be improved through the installation of a fully computerized trading floor system. Consideration may be given to using specialists as market makers to provide additional liquidity for ASE listings.

With fully modern facilities, the ASE will compete effectively with other Canadian exchanges in its traditional role in the domestic market and will attract significant foreign interest through its ability to create sophisticated technical linkages with other markets.

Strong Provincial Government support in increased use of the ASE will help create both the investment climate and the facilities that will attract new business to the Alberta investment community.

F. **Trust Companies**

The Federal Government is reviewing legislation and regulations affecting trust companies. Trust companies are now permitted to purchase common shares of publicly-listed companies under the basket clause of the **Trust Companies Act** of Alberta to a maximum of 10 per cent of their assets. However, trust companies govern their equity investments primarily by quality of the security, and are generally reluctant to take risks.

Trust companies are pressing principally at the federal level for a lessening of the restrictions on consumer and business loans. This is perceived as the area with greater growth potential. Well-managed trust companies will continue to play an important role in Alberta. For a summary of Alberta trust company capital market activities see Appendix I.

An account of current considerations of restructuring in the Canadian trust industry can be found in the Federal Green Paper.

G. **Investment Counsellors**

Most institutional decisions on investment of private capital owned within the province are made in Central Canada or elsewhere. Many submissions advocated the contracting of more investment management to the investment counselling groups whose capacity has been gradually developing in Alberta. This would be an inexpensive and efficient way of increasing local decision-making in financial investments. Consideration will be given to the recommendation for private management of some of Alberta's financial assets.

H. Merchant Banks

In a typical entrepreneurial economy, merchant banks provide important links in the financial infrastructure. Their activities cover a wide spectrum: from venture capital to portfolio management; from loan syndication to export credit guarantees. Merchant banks are used as financial advisors, intermediaries and negotiators in mergers, take-overs, divestitures, loan restructuring and stock market issues. Their activities tend to be catalytic, innovative and are often very complex.

Canada has no legislation providing for the establishment or regulation of institutions known as merchant banks. There are similarities between the activities of some trust companies and merchant banks. The major chartered banks do have merchant bank departments, but their functions differ from true merchant banks.

There is only one, small, merchant banking group in Alberta at present. The Provincial Government uses advisory services of international bankers, and through support of this specialized sector would hope to draw more merchant bankers into the province.

I. Venture Capital Companies

1. Venture Capital Overview

Venture capital presentations to the White Paper process underlined the importance of innovation to the creation of new industries and new wealth, thus increasing the standard of living for Albertans.

It was noted that innovation and entrepreneurship are less likely to occur in a highly structured and regulated economy. In this regard, Canada is at some comparative disadvantage to the U.S. Substantially more private venture capital in the U.S. operates in a less regulated and more open marketplace than in Canada.[15]

The formation of venture capital in Canada is heavily subsidized by government. Such subsidies may be reflective of an end market for products which is much smaller. Canada, for example, does not have a large defence budget which provides enormous financial suport for research and innovation as in the United States. Importantly, Canada also does not have a large and liquid risk equity market, like NASDAQ,[16] in which venture capitalists can realize returns as their investments are listed for trading. Canada and Alberta could benefit from similar market mechanisms.

Annual reports from the Association of Canadian Venture Capital Companies (ACVCC) for the years 1982 to 1984 make clear that venture capitalists behave like other institutional investors. They are highly sensitive to business cycles, to real rates of return in the financial markets and, despite the implications of their name, take elaborate steps to minimize risks.

Venture capitalists invest during the higher risk, early stages of business ventures when the lower risk, more advanced stages are not available or are too high priced.

As one report of the venture capital association notes:

> *. . . this may lend support to the belief that experienced investors such as ACVCC members are more adept at investing in well managed companies. It is also apparent that the majority of investments by ACVCC members (in 1982) involved development or expansion stage companies.*[17]

Much discussion has taken place in Alberta about the stage in the corporate life cycle at which venture capitalists invest. Venture capitalists are perceived as suppliers of risk equity notwithstanding business cycles, high interest rates and other economic factors affecting their financial results.

Despite the high level of government support for private risk investment and direct venture investments such as Vencap Equities Alberta Ltd. (Vencap), the higher risk, start-

---

15. Alta-Can Telecom Inc., Submission to the White Paper Forum.
16. National Stock Dealers Automatic Quotation (NASDAQ).
17. ACVCC 1982 Report, page 8.

up stages of Alberta companies have not attracted venture capitalists. One factor that limits the potential return of Alberta venture capital is the lack of a liquid equity market which would provide a visible exit point such as in the U.S.

One White Paper presentation stated:

> *. . . it must be remembered that the formation of risk capital cannot be encouraged unless there are facilities offered which allow the risk investor to exit from the investment at the appropriate time. An active Alberta Stock Exchange, that encourages the initial public offering of new companies, would do much to aid this process.*[18]

Alberta has an attractive environment for risk investment. Venture capitalists will make risk investments when rates of return are acceptable. Individual investors are demonstrably risk-oriented and, with a more competitive financial infrastructure, could be suppliers of risk capital and beneficiaries of the rewards.

The establishment of an Alberta Stock Savings Plan and the resulting encouragement of a more liquid and viable Alberta Stock Exchange would help create an attractive investment environment for the development of Alberta's innovative opportunities.

For data by ACVCC on venture capital companies see Appendix II.

2. Vencap Equities Alberta Ltd.

Vencap was created as a venture capital company to be owned primarily by Albertans and to serve the long-term economic interests of Alberta.

The development and growth of successful business ventures requires creative, dedicated leadership, sound business judgment and sufficient long-term equity capital. Vencap's mandate is to support competent companies in their areas of endeavour with equity capital and the time, talent, and experience of its staff. Vencap's objective is to create a long-term capital appreciation through the growth and profitability of the companies in which it invests.

In the past, massive amounts of capital have been attracted to Alberta by opportunities in oil and gas and in real estate development. Risk capital to support initiatives in Alberta's industrial sector has not been plentiful. The formation of Vencap was intended to change this. Vencap is to seek out and support, with capital and assistance in management, those worthy endeavours in manufacturing industries, service industries and technological opportunities which show promise of becoming substantial enterprises.

3. Emerging Companies Symposium

Three venture capital symposiums were held in Alberta in 1984-85. In a marketplace environment these symposiums brought together venture capitalists seeking investment opportunities and entrepreneurs offering high growth prospects in return for equity capital. The symposiums provide an arena for the exchange of ideas and techniques behind successful venture capital investment.

The concentrated marketplace created by these symposiums creates a new and successful forum for bringing together new companies and venture capitalists on a regular basis. Although government has no role in these excellent initiatives, they are fully supported in concept and should play an important role in the productive flow of new risk equity.

4. Native Venture Capital Company Ltd. (NVCC)

The Alberta Government, several major Alberta-based corporations, and the province's Native community have joined forces as shareholders to create the NVCC. A first for Canada, the company offers a stable, independent, long-term pool of capital geared to the needs of Native business.

18. Alta-Can Telecom Inc., Submission in Response to the White Paper, pg. 17.

NVCC is interested in investing in new and existing Native enterprises whether large or small, ongoing concerns to be purchased by Native entrepreneurs in joint ventures between Natives and others, and in owner-operated sole ventures. A Native enterprise must operate in Alberta and be controlled by Native Albertans, or where majority control is not held, the business must be of significant benefit to Native Albertans.

5. Alta-Can Telecom Inc.

Alta-Can Telecom was set up to invest in and assist new fast-growing areas of micro-electronics and telecommunications. Formed in 1982 as a wholly-owned subsidiary of AGT, Alta-Can became active in January, 1983.

Alta-Can's primary goal is to encourage and work with businesses in Alberta, and thereby contribute to diversification in this province. In addition, it looks beyond Alberta to develop an investment portfolio that will benefit the province's economy, especially in telecommunication technologies.

J. **Alberta Heritage Savings Trust Fund** (Heritage Fund)

The Heritage Fund has launched several initiatives in the capital markets since its inception. These efforts have been directed at supplying requirements of Albertans which had not been adequately serviced by other intermediaries.

By investing in provincial and crown corporations, the Heritage Fund has helped to finance infrastructure including affordable housing, farms and small businesses. The six crown corporations in which the Heritage Fund has invested are Alberta Opportunity Company, Alberta Agriculture Development Corporation, Alberta Mortgage and Housing Corporation, Alberta Municipal Financing Corporation and Alberta Government Telephones Commission. For further information on these crown corporations see Appendix I.

Other investments by the Heritage Fund are the Prince Rupert Grain Terminal discussed in section IX. B. 1. and Syncrude and The Alberta Energy Company Ltd. are discussed in section X. B. 1.

There are other institutions which make up the Alberta capital market infrastructure whose roles are not specifically to provide equity financing. See Appendix I for further information on Alberta insurance companies, credit unions and the Alberta Research Council.

VII. Constraints on Growth

A. Introduction

Many observations in the White Paper process drew attention to the fact that decisions made by national institutions have restrained the growth of an indigenous financial community. Underdevelopment was noted in segments of the financial market in banking, life insurance, and investment brokerage.

The national and regional banks were the focus of considerable discussion at the White Paper forums and in continuing representations. The problem of banking accommodation for small business is not new. In the context of an Alberta strategy on capital markets, it is, however, worthwhile to consider some recent studies on the banking system's impact on small business and the submissions made to the White Paper steering committee.

B. Canadian Bankers Association (CBA)

In 1981-82, the CBA, in conjunction with the federal Department of Industry, Trade and Commerce, responded to small business criticisms of the major banks' operation in this sector by conducting a national survey of small businesses. The survey revealed that a clear majority of respondents was satisfied with the banks' small business services. However, 36 per cent of respondents were not satisfied with their bank dealings. Complaints were made about the banks' unreasonable collateral demands, unfair repayment constraints, unwillingness to finance innovative ventures, and short-sighted loan policies. Reference should be made to Appendix III for further details.

At the White Paper public forums, representatives of the CBA defended the role of the national banks against the suggestions in the White Paper that the growth of regional financial institutions should be encouraged.

In defence of the chartered banks' point of view the CBA stated:

> *So far as the financing sector of the economy goes, the White Paper comes across as being somewhat interventionist. It is proposed to take measures which will attract more savings to the Treasury Branches. We have some difficulty in defining where is the unserved market segment which the private sector is ignoring? Chartered banks, trust companies, credit unions, and even investment dealers compete for deposits.*
>
> *Canada's chartered banks allow Albertans access to international markets to a degree totally out of proportion to our size. To some extent, this is due to the fact that many of the major banks are global in character, well managed, and have taken advantage of modern technologies to the benefit of consumers. The extra-provincial banks continue to offer to Albertans exposure to national and international financial markets which assist them in the development of financial expertise. This exposure, in turn, fosters a greater awareness of the opportunities which are important in developing local industries.*[19]

The CBA also warned:

> *Governments often adopt programs taken up earlier by their brother and sister governments. Many of the programs detailed in the appendix of the White Paper have close cousins elsewhere in Canada. Attempts to create a more provincial capital market in Alberta could be copied elsewhere, and instead of capital moving efficiently to where it works to the greater benefit of all Canadians, capital may be restricted to certain regions. This would not benefit Albertans. We hope this view is taken to heart when the government implements its White Paper recommendations.*[20]

The CBA presentation is a plausible defense of the national banking system. Perhaps the key to understanding the difference between the CBA position and the perceptions of Alberta businessmen lies in what constitutes the benefit of all Canadians.

---

19. Mr. T. Cumming, CBA, Submission to the White Paper Public Forum, September, 1984.
20. Ibid.

Albertans have noted in the past that the greater benefit for all Canadians can work to the dramatic disadvantage of some Canadians, namely those who are not at the location of the national headquarters. Albertans also vividly recall that the NEP was said to be constructed for the benefit of all Canadians.

Most Alberta businessmen have not expressed a preference for restricting capital to certain regions, rather they seem to favour capital availability in all regions, at all times, on similar terms of trade.

The concern of the CBA about the segmentation of the Canadian capital market into regional and provincial strongholds is a valid one. The Alberta Government also advocates the efficient movement of capital in harmony with regional approaches to equity investment.

There is evidence, however, that the national banks have been part of the segmentation of the national capital market and of the uneven supply of capital in Alberta. This issue has been studied by the Canadian Federation of Independent Business.

C. **Canadian Federation of Independent Business** (CFIB)

In 1982, the CFIB conducted a survey of its members on the subject of banking and small business. While most members were satisfied with their bank dealings, a significant percentage were not. Notable results are found in Appendix III.

In 1984, the CFIB undertook a major study of banking in Western Canada, and gave the White Paper committee the benefit of its findings.

In addition to the statistical results, outlined in part in Appendix III, the CFIB summarized its members' comments regarding banking in the Western region. Much of the statistical evidence is anecdotal and unsystematic, but instructive. Many members expressed annoyance with the inexperience of bankers and their lack of knowledge of small business financing. Many were frustrated with banker mobility. Forty-three per cent of Alberta respondents said they had dealt with three or more bank managers in the past five years. They were also unhappy with what they saw as a strong reluctance on the part of the managers to take risks because of concerns over personal performance records.

A common perception was that small businesses were being squeezed to help the banks support their commitments to big firms. Closely related to these concerns was the perception that with the onset of the recession, bank operations were greatly centralized. This centralization was a decision-making retrenchment in the established Eastern region which had detrimental effects on Western business. With the retrenchment came rigidly conservative lending policies, spawning complaints that the managers were instructed by policies of formula lending dictated by distant and insensitive decision-makers. The effect on Alberta small business has been damaging, according to those who compiled the report.

The CFIB suggests that banks were willing to debt finance small business in good times, but were not willing to remain equally committed when the recession dampened the boom. From the CFIB's analysis of its survey results, the view was expressed that banks have a clear responsibility in helping and maintaining a stable business environment. In the severe downturn years, the major banks did not fulfill this responsibility in the view of small business advocates.

> *It would appear that the banks tended to disregard the effects of their actions on the economy not only during the pre-recession period but also during the recession itself and its aftermath. Bank decisions taken during the late '70s and early '80s certainly affected the severity of the recession and its persistence in the two far western provinces especially.*[21]

---

21. CFIB Banking Survey for Western Canada, 1984.

Many of Alberta's financing problems may not have been so severely felt if the indigenous financial community were of sufficient size and expertise to supply smaller firms with banking alternatives. Through the White Paper process the divergent views on banking indicate that gaps in lending appear to be a significant factor to many Alberta borrowers, especially small business, despite the national banks' position that capital flows in Canada are efficient. This discussion leads to the attendant problem of financial decision-making, where and by whom, specifically addressing the key problem of enhancing the availability of equity in Alberta.

VIII. Addressing the Capital Shortage

A. Introduction

The increasing use of either bank or government guarantees is an illustration of the serious problem which confronts the Province in the shortage of equity capital affecting Canadian business. Many Alberta businesses which were heavily reliant upon the energy and the real estate industries for income and collateral have had to find guarantors to obtain equity.

Guarantees are illustrative of the difficult choices facing corporations, farmers, individuals, banks and governments in the aftermath of a severe recession. Depreciated equity value and high debt ratios have forced businesses to obtain either support or guarantees of financing. The alternative is to see businesses collapse for lack of adequate capital. To illustrate the increasing movement toward guarantees, several examples are cited.

B. Support by the Province — Major Projects

1. Prince Rupert Grain Terminal

In October, 1981, the Premier announced the financing arrangement between the Alberta Government and a consortium of grain companies for construction of a grain handling facility at Prince Rupert, B.C. Alberta has invested over $200 million in this $275 million project. The Alberta Investment Division of the Alberta Heritage Savings Trust Fund has invested about $117 million in first mortgage bonds; the remainder has come from the Province's general revenues and the other members of the consortium.

The investment was made to compensate for a lack of sufficient capital to undertake such a large scale project. Using the most advanced technology, this modern facility will significantly reduce handling costs. As well, farmers will avoid having to pay demurrage charges at the congested Vancouver port. Prince Rupert is 700 km closer to the Pacific Rim than Vancouver, and so is better suited to penetrate export markets for Alberta products.

It is expected the terminal will operate profitably and that the loan will be repaid over the life of the facility, returning the capital to the Heritage Fund.

2. Husky Upgrader

In June 1984, an agreement was reached among Husky Oil and three governments on financing of this major $3.2 billion facility to be built at Lloydminster. The Government of Alberta has agreed to provide a loan guarantee of up to $390 million, in addition to the granting of tax and royalty incentives.

This guarantee is part of Alberta's effort to increase heavy oil supply, underwrite employment and add value, or upgrade, heavy oil before it enters pipelines to Eastern markets. In the longer term, production and upgrading of feedstock should ultimately finance the project, making the government guarantees unnecessary.

3. International Trade Loan Support

(i) Export Services Support Program

International trade is integral to an Alberta economic strategy. The Government has long recognized the importance of international markets and recently underlined this priority by announcing the Export Services Support Program, a three-year $7 million initiative designed to provide financial support incentives to Alberta firms in their pursuit of viable markets. The program will pay for 50 per cent of the pre-contract costs incurred by a firm seeking out export markets. If the pre-contract feasibility studies, travelling expenses, and other costs result in an agreement, the funds advanced will be repayable by the private sector company.

(ii) Export Loan Guarantee Program

The Government has found it necessary to implement the Export Loan Guarantee Program. Its purpose is to guarantee loans made by financial institutions to enable Alberta firms to be more competitive with firms from other provinces in obtaining export sales internationally, interprovincially, or within the province.

A business may not have sufficient working capital to finance the production of export orders, which can be larger than the historical sales level, and may encounter difficulty in obtaining loans from a financial institution. Further problems can arise if the contract for an export sale requires letters of credit for bid and performance bonds. Through the program the Government acts as a catalyst to encourage the financial industry to be more responsive to loan requests from businesses for export purposes.

C. Guarantees by Banks, Treasury Branches and Governments

1. Support Packages

The White Paper process reinforced the view of Albertans that more local financial decision-making is important to economic stability and growth. The Alberta Government expressed its confidence by depositing funds in regional banks to strengthen their operations. Notwithstanding the deposits, some regional banks continued to suffer the effects of the prolonged decline of real estate values and slow economic recovery.

The Canadian Commercial Bank (CCB) notified the Office of the Inspector General of Banks on March 14, 1985 that the deterioration in its loan portfolio could place the bank in a position whereby it could be unable to meet its obligations to depositors and creditors. A support package was designed to maintain the bank as a force in Western Canada's economy.

The support package was not sufficient to re-establish depositor confidence in CCB and the Federal Government announced September 1, 1985 that it was placing the bank in liquidation. The CCB chairman noted: "the bank was unable to turn the corner since it was working against a tight timeline and not in the most hospitable economic environment." The Bank of Canada support package included a stipulation that the CCB should return to profitability by 1986. The CCB could not achieve this objective before it was placed in liquidation.

A parliamentary committee report critical of CCB management was released subsequent to the support package. The report contributed to loss of depositor confidence in CCB.

While the liquidation of a regional bank will slow the growth of development of Alberta's financial infrastructure, the policy of supporting them in a fiscally responsible way is necessary and should be continued.

As in the case of the Federal Government, Alberta's position will be to assess each situation on its own merits. In attempting to reverse the worldwide tendency to seek government guarantees for failing institutions, Alberta will pursue the possibility of expanding a deposit insurance system. An expanded operation of Canada Deposit Insurance Corporation (CDIC) could replace the widespread call on governments for guarantees for financial institutions.

2. Preferred Share Guarantees

There is evidence that even sizeable Canadian corporations had difficulty obtaining adequate equity financing during the latter half of 1984 and early 1985. About a dozen preferred share issues were brought to market carrying either bank, or parent company support agreements to guarantee payment of dividends or principal. These guarantees are evidence of investors' reluctance to buy Canadian equities without some assurance of investment safety.

One such preferred share issue was that of North West Trust Company. The shares were guaranteed by the Treasury Branches, the company's banker for many years. The guarantee was made to strengthen the equity position of North West Trust, which has seen its equity shrink because of decreases in property values.

Appendix IV is a representative chart of support agreements underlying Canadian preferred shares.

D. The Risk of Guarantees

Typically, government guarantees take two different forms: (1) those that are designed to eliminate or reduce the risks associated with loans to targeted sectors of borrowers such as small businesses and farmers, and (2) guarantees to fulfill obligations of financial institutions to their depositors when financial distress forces institutions to default on their liabilities.

Although the purposes of the two types of guarantees differ, they both impose a claim in taxpayers' money. In the case of loan guarantees, the government in effect becomes an insurer of the loans extended to targeted groups of borrowers, and thus artificially reduces the default risks of the loans to the lending institutions. With lower default risks, the borrowers can obtain credit at lower interest rates than those they could secure in financial markets.

While governments use loan guarantees to support certain sectors of the economy, the justification for guaranteeing obligations of credit unions, trust companies and banks is to prevent their failure and to maintain public confidence in the financial system.

It is true that with explicit government guarantees, the depositors would be virtually certain of receiving their monies. As a result they would be more willing to put their savings in smaller regional financial institutions. But small individual depositors of banks and trust companies are already specially protected by deposit insurance.

On the other hand, large depositors elect to put money in smaller financial institutions primarily (although not exclusively) because those institutions offer higher interest rates than the large national banks. The higher interest rates are intended to compensate depositors for exposing their funds to a greater risk of default. Depositors who find the interest rate differentials sufficiently attractive voluntarily expose their deposits to the risk that the financial institution may fail.

The effect of government loan guarantees must not artificially sustain marginal institutions at the expense of their competitors. Neither can government guarantees be employed to protect shareholders' investments in those institutions. In addition, the hidden costs of guarantees, such as alternate use of funds, must be considered in assessing the effectiveness of this increasingly used financial instrument.

It is proposed to pursue an alternate course of expanded insurance coverage similar to CDIC for financial institutions.

Appendix V elaborates further on risk guarantees.

E. Conversion of Debt to Equity

The restructuring of debt to create equity participation in a firm is becoming increasingly common. It is done most often for large corporations whose indebtedness to lenders is so great that the lenders cannot afford to let the firm fail. Nor can the economy withstand the crisis of confidence created by ripple effects from the fall of a large corporation. Most conversion of debt to equity is involuntary; the lenders are impelled to restructure the firm's debt. A recent example of this type of debt restructuring was the move by Turbo Resources Ltd. This debt conversion put 68 per cent of Turbo shares in the hands of its lenders. The restructuring reduced the firm's debt load from $740 million to $319 million. The plan was considered necessary for Turbo's survival by 95 per cent of its shareholders.

The conversion of debt to equity has held less attraction to bankers for the small business community. There are many reasons this accommodation is extended less frequently to small businesses.

Some small scale debt-to-equity conversion does take place in selected cases. Financially strapped firms which cannot service debt at a high interest rate may have this debt converted to preferred share issues to the lending institution. The firm then pays dividends at a rate lower than the interest rate. In this way the debt is serviced under more manageable circumstances. This has occasionally been the practice of the Treasury Branches and other banks.

These accommodations are offered only to those firms which show promise of recovery. While not a desirable business option, debt restructuring through conversion has worked well in many instances as it is preferable to foreclosure or bankruptcy.

F. Farm Loans — Workouts to Preserve Equity

The credit needs of agriculture are unique. Alberta's agricultural sector is based on highly capitalized owner-occupied family farms that require refinancing every generation. Fluctuations in prices, reduced land values and high input costs that occur during cyclical downturns create a continuing demand for credit. Unless credit is available, equity in family farms and agribusiness may be lost. Programs offered by the Alberta Agriculture Development Corporation (AADC), Treasury Branches and major banks continue to play a significant role in providing long, intermediate, and short term financial assistance to farms and agribusinesses.

The principles of workout provisions to save equity can be applied to other businesses as well as to agriculture.

An outline of workout programs is attached as Appendix VI.

IX. Sources of Equity Capital

A. New Sources

1. Small Business Equity Corporations Program (SBEC)

In considering ways to stimulate the generation of small business equity capital in 1983-84, the Alberta Government studied programs operating in other provinces. These programs encourage investors to form corporations with the object of investing risk capital in new and expanding small businesses. In the spring of 1984, legislation was passed to create the Small Business Equity Corporations Program, incorporating the improvements made on similar programs in other jurisdictions.

The SBEC Program provides funds for the purpose of investing in Alberta small business. Up to 30 per cent of the investor's pool of capital can be claimed from SBEC program funds. This money is held in trust and applied to the investments when those investments are made on a pro-rated basis. The incentive is to invest equity capital. By putting equity capital into small businesses, the investing corporation benefits from the program's incentives. While the program encourages firms to invest within a reasonable time, it does not directly influence the investment decisions.

Alberta Tourism and Small Business, to facilitate the placement of funding, performs a clearinghouse function. This service links investing corporations with small businesses seeking equity investment. No investment advice is given.

Applications to June, 1985, indicate that over $150 million of equity capital could be injected into Alberta small business.

2. Alberta Stock Savings Plan (ASSP)

a) Introduction

The recent economic downturn has highlighted fundamental weaknesses in the financial structure of Alberta corporations. These weaknesses impair both the ability of business to recover in the short term and the ability of the provincial economy to diversify and create new jobs.

One of the residual effects of prolonged recession is the very high debt load carried by many enterprises. The ability to raise new equity and reduce debt accordingly would create healthy, vigorous enterprises with the financial ability to expand, create the new permanent jobs needed to reduce unemployment and provide for future Alberta growth.

The changes recently introduced by the Federal Government such as the allowance of investments in private companies by Registered Retirement Savings Plans (RRSP), the incentives for institutional investment in small business and the $500,000 lifetime capital gains tax exemption are all positive initiatives.

The federal budget changes provide inducements to equity formation but do not address the particular investment requirements of Alberta.

An Alberta Stock Savings Plan will attract new investors to the equity market and will provide both a source of capital for emerging Alberta companies and an incentive for new industry to locate in the province. The provincially registered plan will provide tax credits to individuals investing in companies incorporated in Alberta and Canada and will expand listing and trading activity on the Alberta Stock Exchange, thus improving the liquidity and the accessibility of Alberta's marketplace.

The Investment Dealers' Association (IDA) members and the Alberta Stock Exchange (ASE) are prepared to market and administer the ASSP under mutually agreed upon provincial regulations.

b) Objectives of the Program

i) To further support the creation of a financially strong and vigorous private sector by providing expansion capital for growing companies. A financially stable private sector will be in a position to expand, challenge domestic and foreign markets and provide permanent jobs for Albertans.

ii) To provide a logical extension of the Small Business Equity Corporations (SBEC) Program. Companies which have matured under this program would then have access to the public markets for development capital, thus creating liquidity in SBEC and venture capital investments. A second effect would be to re-direct capital to new initiatives.

iii) To attract more Albertans to capital markets and to encourage equity ownership of Alberta companies by Albertans.

iv) To encourage the location of head offices, investment in new plants and industries in Alberta. Large firms would consider establishing subsidiary manufacturing here, if the subsidiary could access equity investment through the ASSP. This new industrial activity would have a positive effect on job creation and industry diversification.

v) To promote and strengthen the ASE and provide the environment for Alberta to evolve into a stronger financial centre for Western Canada.

Details of the proposed ASSP are attached as Appendix VII.

B. **Existing Sources**

1. Alberta Heritage Savings Trust Fund

The work of the Commercial Investment Division of the Fund has been dealt with in Section VI. J. above. The Alberta Investment Division has participated in several equity investments:

(a) Syncrude

The Syncrude Oil Sands project, active for over a decade is an example of large project support by equity investment. The Alberta Government bought a share in the project when a private sector firm withdrew its interest, putting the plant in jeopardy. The Syncrude investment has been profitable for the Heritage Fund as well as for private sector investors. With the combination of its original equity and the exercise of convertible debentures, Alberta's investment has grown to 16.74 per cent of the project.

(b) Alberta Energy Company (AEC)

AEC was established to encourage the participation of Albertans in the development of energy and other natural resources. The general public owns approximately 63 per cent of the outstanding common shares while the remaining 37 per cent is owned by the Province. The Heritage Fund has been gradually reducing its interest in the company. AEC is mature and prefers to increase private sector ownership.

(c) Bank of Alberta

In April 1984, the Bank of Alberta made an initial public offering of shares totalling over $20 million. To support the establishment of this regional bank the Heritage Fund made a $1.6 million investment in its shares, resulting in 5 per cent equity participation. Equity investments, including 7 per cent ownership by Hong Kong investors and a subsequent 10 per cent participation by a large Japanese bank increased the Bank of Alberta's equity capital to over $40 million by the end of 1984. Foreign participation in the Bank of Alberta will provide Albertans with another stable financing vehicle and should help to diversify the economy through international trade.

X. The Regulatory Environment

A. Introduction

The regulatory environment in the securities and financial industry is complex, bureaucratic, and expensive. The private sector is faced with regulations designed to protect the public interest. Many representations have suggested that over regulation has worked against consumer interest by stifling initiative and entangling small business and entrepreneurs in red tape, thus increasing the cost of doing business. The Provincial Government is responding to frequent requests for some deregulation of financial markets.

The Economic Affairs Committee of Government Caucus established a Regulatory Reform Sub-committee to address the problem of inefficient and excessive regulation.

The committee has worked extensively with the private sector to identify and redress regulatory problems. Progress has been made and a new system to establish permanent and ongoing review of old and new regulations was approved by the Alberta Government in mid-1985. The main elements are:

1. In order to facilitate greater public participation in the regulation-making process, virtually all proposed new regulations or amendments will now be circulated to interested public groups for their review and possible comment.
2. An annual report will be produced as a means of reporting to the public the progress that has been made toward deregulation.
3. Government departments are to be encouraged to give particular attention to problems of over-regulation that arise out of either federal and provincial, or provincial and municipal regulation of the same activity.
4. A standing committee of the Government Caucus will be appointed to review and encourage progress toward regulatory reform.
5. A permanent Regulatory Reform Office is being established to assist the Caucus Committee. This office will be associated with the Executive Council.

This new focus on more efficient and cost effective regulation extends to the financial industry, regulated by the Alberta Securities Commission.

B. Alberta Securities Commission (ASC)

The mandate of the ASC is to regulate investment activity in the capital markets of the province by administering the **Alberta Securities Act.** The ASC protects investors by regulating the sale of the investments and licensing of sales people. Such protection is achieved by requiring full, true, and plain disclosure about all material aspects of an investment and by ensuring that only knowledgeable and responsible people sell securities and other investments.

Alberta is attempting to improve its regulatory effectiveness in the interests of lower costs and greater market efficiency. Simplification of regulation and processes reducing the time for the clearance of prospectuses will reduce the relatively high costs to small issuers. Each party involved in the prospectus process including the auditor, the solicitor, the underwriter, and the board of directors, is required to provide full, true and plain disclosure. There is a positive obligation for every professional to diligently examine, inquire and ensure that every material fact relating to the affairs of the issuer which may affect a potential investor is properly stated, examined and disclosed. This entails time, effort and money and increases the cost that the small issuer faces.

Alberta must provide a competitive environment for development of its capital market. The ASC will assure that adequate information is provided to investors, while guarding against the requirement for too much information which takes too long to process and becomes counter productive.

The Alberta Government and the ASC continue to discuss ways of improving regulatory efficiency. Some examples follow.

1. The size of distribution allowable under the private placement exemption section of the **Alberta Securities Act** has been enlarged in the amendments which were passed in the fall

of 1984. An issuer may enlarge its distribution by taking advantage of more than one private placement exemption in distributing the same issue.

2. The ASC continues to review the private placement exemption provision and is reviewing the exemptions for sophisticated investors who are deemed not to require regulatory protection.
3. The ASC is an active participant of the Canadian Securities Administrators Association and works toward the appropriate degree of uniformity of interprovincial securities regulation.
4. The ASC is presently reviewing and revising the securities regulations in order to simplify them. All regulatory forms are being reviewed as well. The ASC is reviewing all of its provincial policies relating to the regulation of securities and is working with the Alberta Stock Exchange on the creation of a policy and format for a simplified exchange-offered prospectus.
5. An ASC recommended study will be undertaken on the integration of the financial services regulation in the province.

C. **Investment Dealers' Association of Canada** (IDA)

As the national self-regulatory organization of the Canadian securities industry, the role of the IDA is to establish and enforce high standards of business conduct. Through study, public statements and representations, the IDA promotes a framework of policies for savings and investment which will encourage the effective allocation of capital.

One of the objectives of the IDA is to encourage, through self-discipline and self-regulation, a high standard of business conduct among members and to adopt, and enforce compliance with, such practices and requirements as may be necessary and desirable to guard against conduct contrary to the interest of members, their clients and the public.

D. **Alberta Stock Exchange (ASE)**

The object of the ASE, owned by its members, is to operate a stock exchange in Alberta for trading by the members of the corporation and other persons as authorized by its bylaws.

The Board of Governors has the power to govern and regulate:

1. The Exchange
2. The partnership and corporate arrangements of the members and other persons authorized to trade on the Exchange, including requirements as to financial conditions.
3. The business conduct of the members and other persons associated with them in the conduct of business.

The Exchange listing and reporting requirements provide an environment for public companies to engage in an effective auction market.

Certain quality tests concerning the affairs of a company are applied to determine whether its securities are appropriate for listing on the exchange.

E. **Harmony in the National Market**

Numerous issues are raised by the division over financial institutions that exists among federal and provincial governments. These are often complex and sensitive. The cooperation and coordination of policy among governments is an important requirement for a smoothly functioning system. Conversely, differences in regulatory philosophy on the part of the various regulatory authorities can lead to difficulties.

There are two practical approaches to resolving the problems of overlapping responsibilities and potentially conflicting policy approaches at the two orders of government. First, federal and provincial governments could attempt to resolve the jurisdictional overlaps. This would involve negotiations toward an agreement regarding which types of institutions and activities which would be under federal jurisdiction, and which would be under provincial jurisdiction.

Second, the federal and provincial governments could attempt to harmonize their approaches to regulatory change. This is the Federal Government's preferred route and its Green Paper suggests moves in this direction.

XI. Education

A. Introduction

The White Paper emphasized the vital area of education in the fullest sense, including education in economic and investment processes.[23]

There is a global acknowledgement that education is the key if a nation wishes to maintain a role in the world's economy and culture.

An excellent presentation to the White Paper forums emphasized the point:

Knowledge . . . new ideas, discoveries, deeper understanding, better facts . . . are now the basic capital, the fundamental requisite, as crucial as land or oil . . . America's colleges and universities . . . are the motors that drive scientific and technological innovation, the incubators of innovative art, poetry and music, the springboard for foreign language fluency and knowledge of world cultures and religions, the schools that advance our understanding of economics, history and social philosophy . . . Higher education therefore has become our country's new vital centre[24]

What can be said of America's education is equally applicable, perhaps on an urgent basis, to Canada's. This section on education, as it bears on capital markets, equity and risk evaluation, is fundamental to development of a sophisticated investing public.

B. Teacher Internship in Business Project

Delivery of marketplace education is a key consideration. As a positive response to the White Paper, a program was instituted by the Calgary Board of Education on the initiative of the Alberta Foundation for Economic Education. The program placed selected high school teachers in the offices of corporations for a five-month period to enable them to participate in business functions. Two teachers were employed in a pilot program, one with a national bank and the other with a major oil company. Since the end of the internship, the teachers have spoken to seminars of teachers and to the business community. They also brought the benefit of their five-month business experience to their students.

An important aspect of this arrangement, worked out by the Alberta Foundation for Economic Education (AFEE), the Alberta Government, the Calgary Public and Separate School Boards and the businesses involved, was the policy of seconding teachers from the classroom for a portion of the school year without loss of salary or benefits.

C. Junior Achievement

Junior Achievement operates several programs designed to expose young people to the world of business.

1. A Teenage Business Program is supervised by members of the business community. High school students learn to capitalize, operate, and finally liquidate their own companies over the course of a nine-month period.
2. Project Business is a new program wherein experienced business people speak to Grade 9 students on general topics related to business. Where the opportunity exists, this program is incorporated into the social studies curiculum, providing a more comprehensive treatment of the subject matter.
3. Applied Economics is a pilot project conducted in Calgary to introduce Grade 11 and 12 students to the market system through the use of computers.
4. Business Basics is intended for Grade 6 students. This course covers some of the fundamental concepts behind business practices.

---

23. White Paper, pg. 67.
24. Don Baker, Mount Royal College, pg. 5.

D. Continuing Education

Many educational institutions, particularly those in the urban centres of Edmonton and Calgary offer courses to the general public on investment strategy, personal financial management, and more theoretical studies of the economy. These courses discuss the operation of the stock market and banking sector and introduce students to financial controls. The Calgary Board of Education, Southern Alberta Institute of Technology, Northern Alberta Institute of Technology, the three major universities, and the major community colleges offer such courses.

Grant MacEwan Community College in Edmonton operates tutorial seminars that complement the securities course offered by the Canadian Securities Institute. A significant number of the general public also take the correspondence course, a requirement for prospective investment dealers.

E. Canadian Securities Institute (CSI)

Investment education for members of the securities industry and the general public is provided in Alberta and nationally by the Canadian Securities Institute. Founded in 1970, the Institute is sponsored by the Investment Dealers Association and the Montreal, Toronto, Alberta and Vancouver Stock Exchanges. Its head office is in Toronto and regional offices are maintained in Montreal, Calgary and Vancouver.

The CSI's core course which is required for provincial registration to sell securities is the Canadian Securities Course (CSC) and its accompanying **Manual for Registered Representatives.** The CSC is offered continuously by corresondence and attracts thousands of industry and non-industry enrollments each year.

The CSI also plays a support role for those of its members who, on their own initiative, conduct talks and seminars for groups and organizations around the province. The CSI provides videotapes and films on the investment process, pamphlets on investment and other aspects of the financial industry, and information on other organizations directly involved in the industry.

F. Government Programs

Three Provincial Government departments are directly involved in educating Albertans on the opportunities and the risks of the small business and investment sectors of the Alberta economy. The departments involved are Tourism and Small Business, Economic Develpment, and Consumer and Corporate Affairs. The latter department is responsible for protecting potential investors against undue risks and abuses of the system; whereas the other two are interested primarily in facilitating the creation and expansion of business and equity investment in Alberta.

Appendix VIII lists the various programs provided by the Government in this area. Several of these offer counselling services on business plan development, financing options, and marketing strategies. In addition, these departments play an informational role, providing all the data a business may require in making decisions related to business.

XII. Conclusion

This policy paper has used much of the valuable input received from the White Paper process as a basis for development of a strategy for enhancing Alberta's capital market. While some of the elements discussed require Government initiative, most of the improvement is dependent on cooperative response from the private sector.

This paper seeks to create the grounds for a more functional and self sufficient equity market. Government proposes to provide support where necessary and encourages the private sector to continue to carry the initiative. The Government underlines its wish not to intervene in business affairs except to offset market failure or unnatural disadvantages of various kinds which have at times had negative impact on the people of Alberta.

APPENDIX I

ALBERTA CAPITAL MARKET INFRASTRUCTURE

1. Insurance Companies
2. Credit Unions
3. Alberta Research Council
4. Investment Activities of Trust Companies
5. Alberta Heritage Savings Trust Fund
   - 5.1 Alberta Opportunity Company
   - 5.2 Alberta Agricultural Development Corporation
   - 5.3 Alberta Mortgage and Housing Corporation
   - 5.4 Alberta Municipal Financing Corporation

1. Insurance Companies

As noted in the White Paper, the presence of any indigenous life insurance company is now in question even though Albertans are substantial investors in life insurance coverage.[A] There can be little doubt that, with hundreds of millions of dollars paid by Albertans every year, one or more indigenous life companies could retain a sizeable portion of that sum in Alberta and manage its investment from within the province.

Just as the benefits of an indigenous company are acknowledged, so are the difficulties associated with the start-up of such a firm. The immediate infusion of a vast amount of capital, approximately $20 million, would be required with long term payout the only incentive for investors.

There are several smaller Alberta based life and casualty companies which have enjoyed success. They are not, however, large equity investors in Alberta. The chart which follows includes current Alberta companies.

INSURANCE COMPANIES IN ALBERTA

Federally Chartered & Headquartered in Alberta	Sovereign General Insurance Co.	Meeting capital requirements
	Sovereign Life Assurance Co. (formerly Family Life)	Active company
	Financial Life Assurance Co. of Canada	Transferring HO to Toronto
	Principal Life Insurance of Canada	A dormant company not operating
Provincially Chartered & Headquartered in Alberta	Alberta Motor Association Insurance Company (Property & Casualty)	Active company
	Canada West Insurance Co. (Property & Casualty)	Active company
	Western Union Insurance Co. (Property & Casualty)	Active company

A. Proposals for an Industrial and Science Strategy for Albertans: 1985 - 1990, page 50.

Peace Hills General Insurance Co. (Property & Casualty)	Active company
Mennonite Mutual Relief Insurance Company (Confined to Mennonites)	Active company
Alberta General Insurance Co.	Being wound up
Rocky Mountain Life Insurance	In administration. No longer selling policies
Paramount Life Insurance Co.	In liquidation

2. **Credit Unions**

Credit unions have a long history of service to Albertans, both in urban and rural communities. Currently, five hundred thousand Albertans are members of credit unions.

Like other financial institutions, however, they have not been spared the effects of the boom of the late 1970's and the subsequent steep downturn. Lending by credit unions was primarily for the purchase of real estate by individual members. Real estate values dropped to a point where those assets that credit unions held fell below the original mortgage values.

The Credit Union Stabilization Corporation (CUSC), guarantor of deposits for Alberta's one hundred and thirty eight credit unions, was incorporated in 1974. In September of 1984, the Alberta Government announced it would backstop or become a lender of last resort for the Stabilization Corporation, since its reserves and lines of credit may not have been sufficient to assure the protection of depositors. At the time, the Government also announced the establishment of a Minister's Task Force on Credit Unions, whose purpose was to study the organization of the credit union system, review its total structure and consider appropriate methods of introducing equity into the system to provide for the long-term strengthening and stability for credit unions in Alberta. The Minister of Consumer and Corporate Affairs received that report in mid 1985.

Since then, a subsidiary of the CUSC has been created to manage and, where appropriate, sell the real estate assets of individual credit unions. The Alberta Government has assisted the Stabilization Corporation by guaranteeing interest-bearing debentures issued by the subsidiary in exchange for the property.

3. **Alberta Research Council** (ARC)

The ARC is a crown corporation dedicated to promoting responsible economic development in Alberta through science and technology. The ARC conducts research on several areas of technological concentration, and also provides advisory and technical services to Alberta manufacturing companies.

Currently underway at the ARC is a joint venture program whereby the ARC offers its facilities and experience in research and development to high technology firms wishing to pursue their own projects in cooperative joint research arrangements. ARC will share equally in the funding of each joint research project up to a maximum of $500,000 per year (up to four years with option). The ARC will share in the licensing of the technology developed, but does not wish to take an equity position. This quasi-equity participation must be considered as occasional and specific as a source of equity capital.

4. **Investment Activities of Trust Companies:**

There is a clause in the **Alberta Trust Companies Act,** s. 131(1), called the basket clause which provides for any non-prohibited investment. The clause reads:

> S. 135(1) Subject to the regulations, a provincial company may, with the company's own funds and its deposits and investment money, make investments and loans not otherwise authorized and not prohibited by this Division.
>
> (2) Subsection (1) shall not be construed so as to enlarge the authority conferred by this Act to invest in mortgages, charges or hypothecs or to lend on the security of real estate or leaseholds.

In the regulations the restrictions within the basket clause are:

> S. 32(1) The amount of a company's investments and loans under section 135 of the Act in or on any one security shall not exceed 15 per cent of the company's unimpaired capital.
>
> (2) The aggregate amount of a company's investments and loans under section 135 of the Act shall not exceed 10 per cent of the company's total assets.

Prohibited investments refer principally to conflict of interest situations. Within the basket clause the trust companies are free to make any kind of investment subject to the percentage limitation. However, their criteria is not whether the investment qualifies for the basket clause but rather whether it is a good investment.

5. **Alberta Heritage Savings Trust Fund**

5.1 Alberta Opportunity Company (AOC)

The AOC provides loans, loan guarantees, and financial guidance to small businesses throughout the province. Loans are extended on a "lender of last resort" basis with priority given to businesses located outside major centres. In 1984-85, AOC made two hundred and seventy-seven loans and fifteen guarantees; its direct lending activity totalled $27 million. By March 31, 1985, total investment into the AOC by the Heritage Fund was $167 million.

5.2 Alberta Agricultural Development Corporation (AADC)

The AADC provides loans and loan guarantees to farmers and agribusinesses. The AADC's programs are designed to foster the establishment and maintenance of family farms and improvements in their productivity, and to encourage processing within Alberta of the province's agricultural products. Direct loans are made at preferred rates of interest and most borrowers are eligible for incentive rebates of part of their interest cost. Total investment in AADC at March 31, 1985, was $955 million.

5.3 Alberta Mortgage and Housing Corporation (AMHC)

On August 1, 1984, the Alberta Housing Corporation and the Alberta Home Mortgage Corporation were merged into the Alberta Mortgage and Housing Corporation. Continuing the programs of its predecessors, the AMHC assist Albertans in two ways: it constructs rental housing for senior citizens and low to middle-income Albertans; and it makes mortgage loans to help low and middle-income Albertans find affordable rental and ownership housing in the private market.

Under the Senior Citizens Self-Contained Housing Program, funds were committed to construct three hundred and thirty-seven units in 1984-85. These projects, for healthy and active seniors, are found in communities throughout Alberta. As well, commitments were made for sixty-five units in the Senior Citizens Lodge Program and twenty-one units under the Community Housing Program for low to moderate-income Albertans of all ages. This housing is provided at rents geared to income.

AMHC committed $39 million for mortgage financing under its Family Home Purchase Program in 1984-85. These loans, together with subsidies to reduce monthly mortgage payments, enabled eight hundred and thirty-one Alberta families to purchase their own homes.

Total investment at March 31, 1985 was $3,374 million.

5.4 Alberta Municipal Financing Corporation (AMFC)

At March 31, 1985, the Heritage Fund held $1,455 million in AMF debentures. During 1984-85, however, the AMFC did not borrow from the Heritage Fund. Instead AMFC successfully raised long term financing in the Canadian capital market and borrowed from the Canada Pension Plan Investment Fund.

AMFC makes loans to Alberta's municipalities, school systems and hospitals and are an economical source of long term capital financing. AMFC's borrowers benefit from a Provincial Government guarantee of AMFC's borrowings and from access to a variety of capital markets.

APPENDIX II

VENTURE CAPITAL COMPANIES ACVCC REPORT, 1984

1. STAGE IN CORPORATE LIFE CYCLE OF VENTURE CAPITAL RECIPIENT

NUMBER OF INVESTMENTS AND AMOUNT INVESTED IN RECEPIENT ($MILLIONS)

STAGE IN LIFE CYCLE OF RECIPIENT	1984				1983				Average (1977 - 1982)			
	#	%	$	%	#	%	$	%	#	%	$	%
Start-up	33	28%	$ 25.5	33%	25	23%	$ 12.3	12%	25	28%	$ 14.9	26%
Turnaround	4	3	2.9	4	12	11	8.0	8	8	9	5.3	9
Development	38	32	15.9	21	37	34	18.3	17	26	29	13.1	23
Expansion	34	28	19.8	25	20	19	28.5	27	22	24	16.2	29
Buy-out	9	8	13.2	17	13	12	37.5	35	7	8	4.0	7
Did not state	1	1	0.1	0	1	1	0.4	0	2	2	2.8	5
TOTAL	119	100%	$ 77.4	100%	108	100%	$105.0	100%	90	100%	$ 56.3	100%

2. GROSS REVENUE OF VENTURE CAPITAL RECIPIENTS

GROSS REVENUE OF RECIPIENT IN MILLIONS OF DOLLARS	1984				1983				Average (1977 - 1982)			
	#	%	$	%	#	%	$	%	#	%	$	%
$0 - $1	49	41%	$ 27.1	35%	39	36%	$ 18.9	18%	37	41%	$ 20.3	36%
$1 - $4	27	23	14.2	18	30	28	15.3	15	20	22	9.2	16
$4 - $9	18	15	12.2	16	13	12	10.5	10	7	8	5.3	9
Over $9	25	21	23.9	31	26	24	60.3	57	14	16	14.8	27
Did not state	0	0	0.0	0	0	0	0	0	9	10	6.1	11
Not applicable	0	0	0.0	0	0	0	0	0	3	3	0.6	1
TOTAL	119	100%	$ 77.4	100%	108	100%	$105.0	100%	90	100%	$ 56.3	100%

APPENDIX II (cont.)

VENTURE CAPITAL COMPANIES
ACVCC REPORT, 1984

3. GEOGRAPHIC LOCATION OF VENTURE CAPITAL RECIPIENTS

LOCATION OF PRINCIPAL FACILITY OF RECIPIENT	NUMBER OF INVESTMENTS AND AMOUNT INVESTED IN RECEPIENT ($MILLIONS)											
	1984				1983				Average (1977 - 1982)			
	#	%	$	%	#	%	$	%	#	%	$	%
Ontario	30	25%	$ 16.0	21%	37	34%	$ 29.5	28%	29	32%	$ 18.2	32%
Quebec	13	11	13.5	17	8	7	12.9	12	12	13	5.4	9
Alberta	14	12	13.5	17	7	7	3.1	3	5	6	3.1	6
British Columbia	8	7	4.1	5	5	5	3.4	3	5	6	5.0	9
Prairie Provinces	3	2			2	2			1	1		
Maritimes	0	0			0	0			2	2		
Yukon & N.W.T.	1	1	1.9	3	0	0	3.0	3	1	1	0.7	1
Canada and foreign countries	0	0	0.0	0	7	7	34.4	33	8	9	10.5	19
Foreign countries	50	42	28.4	37	42	38	18.7	18	22	25	12.3	22
Did not specify	0		0	0	0	0	0.0	0	5	5	1.1	2
TOTAL	119	100%	$ 77.4	100%	108	100%	$105.0	100%	90	100%	$ 56.3	100%

* Note that a summation or combined total is provided for the Prairie Provinces, the Maritimes, Yukon and Northwest Territories.

APPENDIX III

BANKING STUDIES

1. **Canadian Bankers Association (CBA)**

1.1 Selected results of the 1982 national survey:[A]

1.1.1 The majority of small businesses (64 per cent of the survey respondents) are generally satisfied in their dealings with the chartered banks. These companies obtained their required amount of bank financing, felt their banker had a good understanding of their business, and were satisfied with the general relationship they had established with their bank.

1.1.2 A significant portion of the respondents (36 per cent), however, were not entirely satisfied with their bank dealings. The major areas of complaint involved the amount of financing they were able to obtain, the collateral demands of the banks and the interest rate charged. The smaller companies in the sample reported more frequent financing problems than the larger companies who responded to the questionnaire.

2. **Canadian Federation of Independent Business (CFIB)**

2.1 Selected results of the 1982 national survey:[B]

2.1.1. On average, almost three-quarters of the respondents expressed a degree of satisfaction with the banks that serve their business. Although generally satisfied with their banking relationship, these respondents did report some significant problem areas; 26.4 per cent indicated dissatisfaction with their banks' service.

2.1.2 The first issue on which the CFIB's members gave a failing grade to the banking community as a whole was the question of whether their banker knows how to put a financing package together. On this question the results were: Yes — 47.8 per cent, No — 26.1 per cent.

2.1.3 The other area where the banking community received negative ratings was collateral. When asked to describe the collateral or security requirements attached to their loans, the members replied: Lenient — 4.8 per cent, Reasonable — 43.4 per cent, Excessive — 51.8 per cent.

2.2 Selected results of the 1984 Western Canada survey:[C]

2.2.1 The proportion of members with operating loans and those with term/capital loans tended to increase by size of firm measured both by number of employees and sales category. As companies grew in size, they borrowed increasingly from financial institutions.

2.2.2. Alberta has a lower than regional average percentage of members with operating loans, indicating the caution of both businesses and the banks operating in the province. Alberta's percentage is 69.3 per cent; the region's, 71.9 per cent.

2.2.3. In Alberta, 30.2 per cent of respondents reported that in the past year banks either requested additional collateral on loans or reduced credit lines or both. The regional average was 28.4 per cent.

2.2.4. 64.8 per cent of the respondents in the region considered the banks' above actions unfair; 23.5 per cent regarded the actions as fair.

A. These results are quoted in J. Hatch, et al, "Bank Loans to Small Business," Canadian Banker and ICB Review (February, 1982), p. 7. The survey was taken of "business managers" across Canada.

B. These results are taken from Canadian Federation of Independent Business, Analysis of Bank Survey Results, December 16, 1982.

C. This is a sampling of the results found in Canadian Federation of Independent Business, CFIB Banking Survey for Western Canada, Toronto, December 6, 1984.

APPENDIX IV

SUPPORT AGREEMENT PREFERRED SHARES

List 1 — Issues Supported by a Parent Company.

Dividends from these issues are treated as ordinary dividend income.

Issues	Supported By	Comment
Hammerson Canada 9.12%	Hammerson PLC	*Retr 31/Dec/89&91 @ $25
ITT Canada 9%	ITT Corporation	Retr 31/Jan/90-95 @ $25
U.S. Steel Canada 9%	U.S. Steel Corporation	Retr 30/Apr/90 @ $25
Ultramar Capital 8.7%	Ultramar PLC	Retr 30/Jun/90 @ $25

List 2 — Issues Supported by a Bank or Government

Issues	Supported By	Comment
Atlantic Shop Ctr. 9.25%	Barclays Bank of Canada	Retr 6/Nov/91 @ $25
B.C. Rail $2.3125	Province of B.C.	Retr 1/Jun/89 @ $25
Bentall Corp. 9%	Citibank of Canada	Retr 31/Dec/89 @ $25
Canfor Capital Ser-1V/R	Bank of Montreal	Dividend 70% of Prime
Fidinam Prop. 9.75%	Citibank of Canada	Retr 30/Jun/91 @ $25
JDS Capital 8.875	Citibank of Canada	Retr 1/Apr/90 @ $25
Manitoba Properties	Province of Manitoba	Retr 30/Jun/90 @ $25
Teck Corp 9.25%	Barclays Bank of Canada	Retr 15/Dec/90 @ $25
ULS Capital Corp. 9%	C.I.B.C.	Retr 15/Jan/95 @ $25

* retractable

APPENDIX V

GOVERNMENT GUARANTEES FOR FINANCIAL INSTITUTIONS*

Typically, government guarantees take two different forms: (1) those that are designed to eliminate or reduce the risks associated with loans to targeted sectors of borrowers (e.g., small businesses, farmers, fishermen, etc.); and (2) guarantees to fulfill obligations of financial institutions to their depositors when financial distress forces financial institutions to default on their liabilities.

Although the purposes of the two types of guarantees differ, they both impose a claim on taxpayers' money. In the case of loan guarantees, the government, in effect, becomes an insurer of the loans extended to targeted groups of borrowers, and thus artificially reduces the default risks of the loans to the lending institutions. With lower default risks, the borrowers can obtain credit at interest rates that are lower than would otherwise be securable in financial markets.

The obvious beneficiaries of government loan guarantees are the borrowers. However, these benefits do not come without costs. Since taxpayers' money is used to cover defaulting loans, guarantees transfer wealth from many to a designated few.

Governments, unlike a competitive marketplace, are not well equipped to assess the benefits and risks of allocating "cheap" funds to selected sectors of the economy. Frequently, the alternative uses of public funds are overlooked. As a result, the implicit costs of the loan guarantees tend to get ignored. Without proper attention to these costs, loan guarantees tend not to allocate scarce public savings to their best uses in the economy.

Beyond that, even within a particular sector targeted for government loan guarantees, credit risks of individual borrowers tend to differ widely. By extending blanket loan guarantees to a designated sector, the government in effect, artificially equalizes credit risks among individuals in the sector. As a consequence, high risk borrowers in the sector obtain an unfair advantage vis-a-vis others who manage their operations or finances more efficiently at lower risks. Thus, loan guarantees artificially sustain marginal establishments in operation and prevent their better managed competitors from capturing a larger slice of the total production and from expanding their market shares.

While governments use loan guarantees to subsidize certain selected sectors of the economy, the proffered justification for guaranteeing obligations of such financial institutions as credit unions, trust companies and banks etc. is to prevent their failure and to maintain confidence in the financial system. It is true that with explicit government guarantees the depositors would be virtually certain of receiving their monies and as a result be more willing to put their savings in smaller regional financial institutions. But small individual depositors of banks and trust companies are already specially protected by deposit insurance. On the other hand, large depositors select to put money in smaller financial institutions primarily because those institutions offer higher interest rates than the large national banks. The higher interest rates are intended to compensate the depositors for exposing their funds to greater risk of default. Depositors who find the interest rate differentials sufficiently attractive voluntarily expose their deposits to the risk that the financial institution may fail.

When the government guarantees the deposits at small financial institutions, the rate differential between the large national banks and the small regional institutions would impound only a convenience premium, and would become narrower. Depositors who are willing to accept a certain level of risk in return for higher yields would be deprived from these opportunities.

More importantly, government guarantees or bailouts of regional financial institutions would have serious undesirable consequences and costs. When the government explicitly or tacitly guarantees the obligations of financial institutions, the incentives for prudent management of the

* The section is a personal view of Dr. Seha Tinic and does not necessarily reflect a government position.

affairs of these institutions diminish considerably. With government guarantees at least some of the financial institutions would find taking on higher risks on their asset portfolios attractive. Instead of diversifying their loan portfolios and spending adequate resources for appropriate credit evaluation, the financial institutions may concentrate their loans by size, industry sector and geographically to earn large risk premiums. Obviously, if things go well their shareholders would reap the benefits. Otherwise, the taxpayer would end up with (the banks') liabilities to their depositors.

Beyond protecting the depositors, government bailouts of financial institutions may also have an unintended consequence: they may subsidize the losses of the shareholders of these institutions. When the value of the assets of a financial institution falls short of its liabilities, the shortfall has to be absorbed by the uninsured depositors and the institution's owners. However, when taxpayers' money is used to bailout a financial institution's non-producing assets without acquiring a commensurate share of the ownership in the institution, the private owners of the institution would lose less than they would have had the institution failed. Few would find it appropriate for the government to use taxpayers' money to share in the losses of private investors.

It is highly questionable whether failure of a few small regional financial institutions, which remain vulnerable to the economic cycles in certain industries, would erode the public's confidence in the financial system. Even if it does, however, there is a economically efficient way of protecting the interests of the depositors without resorting to government guarantees or bailouts. The solution lies in an improved deposit insurance scheme. Efforts should be directed towards establishing a nationwide deposit insurance scheme which enables all financial institutions (who so desire) to participate in a national deposit insurance plan along lines of CDIC. The insurance premiums charged to the members of the plan should reflect the actuarial characteristics of the participating financial institutions. Depending on their (1) capitalization; (2) deposit rates; (3) diversification of the asset portfolio by loan size, industry, geographically, cash or cash equivalent assets; (4) earnings; and (5) quality of management, financial institutions should be charged varying insurance premiums.

Besides providing deposit insurance coverage, the agency can also rate the financial prospects and safety of its member institutions and widely publicize these ratings. Similar to the ratings by the Dominion Bond Ratings Service, this information would be useful to prospective depositors in assessing the failure risks associated with various financial institutions competing for their deposits.

APPENDIX VI

WORKOUT PROGRAMS TO SAVE EQUITY

1. **Farm Development Guarantee Program**

A new farm financing initiative, the Farm Development Guarantee, was announced in January, 1985. This program, administered by the Alberta Agricultural Development Corporation, will provide special assistance in operating loan guarantees of up to $100,000 of new operating loan advances to farmers who develop a workout plan and who cannot obtain financing elsewhere. Loan guarantees under this program will be issued for up to one year with a possible one year renewal during the first two years of the program. They will bear interest at the lenders' prime interest rate. An essential element of this program is that existing commercial credit will remain in place.

2. **Major Banks' Programs**

Major banks have instructed branches to give farmers who are experiencing serious financial difficulty many opportunities to maintain their operation.

The major banks, for example, have set out the following policies for helping farms in financial difficulty.[A]

2.1 Criteria

The bank requires the farmer to meet only five criteria:

2.1.1. The management capabilities of the farmer must be capable of turning the operation around.

2.1.2. A reasonable degree of equity must remain in the farm operations so that the borrower still has a financial stake in the success of the operation.

2.1.3. There must be no evidence of fraud.

2.1.4. Financial projections must indicate a reasonable prospect for making future loan payments.

2.1.5. The client must undertake to maintain detailed financial records and to provide the bank with a regular update of the financial progress against plan, including evidence of security holdings agreed to in advance.

2.1.6. When a client meets these five criteria, a letter of commitment is written spelling out all relevant details and conditions of the continued support.

2.2 Policy Options for Continued Support

Each farm situaton is unique and must be treated as such. But there are a number of general options that can be considered in attempting to set up a workout arrangement for farmers in severe financial trouble. These options include:

2.2.1. Debt Restructuring and Consolidation

Where much of the farm debt is relatively short term it can often be rescheduled over a longer repayment period, generally in line with the lifetime of the assets involved and the available cash flow. Normally, the refinancing period is kept as short as possible so there is a fairly close fit between available cash flow and annual debt commitments.

While that approach means that a fairly heavy debt servicing pressure will be maintained, the door is still open for a further terming out of loans, if necessary. Debt restructuring often represents the last chance to bring debt repayment in line with income. It's a step that shouldn't be entered into lightly.

A. Taken from the Royal Bank's monthly newsletter, Royfarm Business Review (November, 1984).

2.2.2. Deferment of Interest and Principal Payments

In selected instances, the bank will defer principal and/or interest repayment on part of a loan for a specified time period to buy additional time in the hope of future income recovery. Any available cash is expected to be used to retire bank loans.

2.2.3. Capitalization of Interest

Where considerable unpaid interest exists and cannot be repaid from current income, the bank is prepared to capitalize or add this interest to the principal balance of a loan and refinance the total amount over a longer period. This option helps buy additional time and provides temporary breathing room for hard pressed borrowers.

2.2.4. Interest Rate Concessions

The bank's general policy on interest rates is to establish rates which adequately reflect the degree of loan risk, the term of the loan and the amount of ongoing administration required for the loan account. When interest rates are particularly high, the added cost of loan payment makes it more difficult for a farm to survive. Where a future turnaround in the operation can be expected, any special programs available are used to help reduce interest rates. This may include Small Business Bonds or special government guarantees on specific loans.

2.2.5. Partial Liquidation of Assets

Selling part of the farm to reduce outstanding debt is not a particularly welcome option for most farmers. It may not even be viable unless a ready market exists. But in many cases, downsizing the farm through liquidating part of it can be a big help in bringing debts in line with the available debt servicing capacity.

2.2.6. Loan Set Aside

From time to time, the bank encounters situations where a normal debt consolidation is still not sufficient to provide a match between existing loan commitments and debt serviceability at current levels of income. Where the only alternative is a wind-up of the operation, the bank is prepared to consider temporarily setting aside a portion of the loan if the operator's management ability is judged to be capable of turning the operation around under more normal income conditions. Under these arrangements, the remaining debt is expected to be serviced on schedule and the total portion of the loan set aside is taken back into repayment again as soon as income conditions improve. The objective is simply to buy time for what is expected to be a better income position in the future.

2.2.7. Continued Support with Government Guarantees

While an operation may be judged to be no longer viable, the bank will still be prepared to entertain continued support with a clearly defined government guarantee on present and/or additional loan funds.

2.2.8. Quit Claim and Lease-back of Property

In certain cases where the operation must be wound up, the bank will consider taking over the farm property on a quit claim basis on the understanding that it may then be leased back to the incumbent with a future option to repurchase. Because of the varying legislation in each province regarding land ownership, this option may not always be possible. The bank is only prepared to consider such a move where the farmer has access to necessary operating equipment and there appears to be a reasonable chance for repurchase of the farm when economic conditions improve. Where a lease-back is involved, leases will be renewable annually at a yearly rate reflecting the general carrying cost of the property to the bank. This option will not be used extensively, but it may buy additional time for either a repurchase of the unit or better future resale possibilities.

APPENDIX VII

ALBERTA STOCK SAVINGS PLAN (ASSP)

1. Outline
(The outline of the ASSP is subject to modification in the development of details which will be incorporated in the required legislation).

1.1. Maximum Yearly Eligible Investment —$15,000. Not including RRSP and RPP contributions.

1.2. Eligible Shares —Treasury, voting, non-redeemable common shares.

—Non-callable new issue preferred shares convertible into common shares with voting rights.

—Warrants to purchase eligible shares would qualify only if issued as part of a unit offering.

—Must be listed on ASE.

1.3. Investor Incentive —Tax credit would be earned upon purchase of eligible shares.

—Tax credit to be used against Alberta tax payable with no carry forward or backward of credit.

—The size of the credit would be based on revenues of the issuing company as follows:

0 to 6 million	40 per cent
6 to 20 million	25 per cent
20 million +	10 per cent

1.4. Distribution of Eligible Stock —Must be distributed by an Investment Dealer and/or a Broker-Dealer or a syndicate of Investment Dealers and/or Broker-Dealers who are registered under the **Alberta Securities Act** and are members of the Alberta Stock Exchange.

—Distribution may be made by:
1.4.1—Prospectus
1.4.2—Statement of Material Facts
1.4.3—Private Placement
1.4.4—Rights Offering Circular
1.4.5—Exchange Offering Prospectus
1.4.6—Warrants if issued as part of limited offering.

1.5. Qualifying Companies —May be federally chartered or provincially incorporated with offices in Alberta.

—Must pay at least one-half of wages to employees in Alberta.

1.6.	Sunset Provision	—Provides for termination of plan in 5 years unless renewed.
1.7.	Custody of Shares	—ASSP shares would be solely held by the ASE Depository which would provide members with Statement of Account activity.
1.8.	Operation of Plan	—A planholder would be required to maintain level of investment for two full years following the year or date of purchase (eg. contributions if claimed on Dec. 31/86 would be maintained in the plan until Jan. 1/89).

APPENDIX VIII

GOVERNMENT SMALL BUSINESS ASSISTANCE PROGRAMS

The following list covers the variety of programs in place to advise business people in Alberta on how to establish and expand their enterprises.

1. **Alberta Tourism and Small Business**

Alberta Opportunity Company (AOC) — In addition to providing financial assistance, AOC offers its clients counselling on management and financial affairs.

1.1 Business counselling and counselling assistance for small business is available for both new and operating businesses. Assistance is offered for the formation of business plans, tax and legal requirements, potential start-up and operating difficulties, proper decision-making processes, financial counselling, and marketing strategies. Business workshops offer the same services but to larger groups.

1.2 Chamber of Commerce Program — Department personnel work with local Chambers of Commerce to further local economic development in rural Alberta.

1.3 Management Assistance Program — Private management consultants are provided for the benefit of small businesses; comprehensive assessment of all aspects of business operation is undertaken. Another objective of this program is to encourage the province's management consulting firms to participate in small business counselling and program development.

1.4 Research and Analysis Program — In-depth research is done on business and financial trends and provided for department personnel and businesses utilizing their services.

1.5 Small Business Guides — The business counselling unit has developed a set of small business handbooks containing information on start-ups, financing, marketing, and business operation in Alberta.

2. **Alberta Economic Development**

2.1 Industry Development Branch — This Branch provides counselling, advice, and assistance to manufacturing companies wishing to establish or expand business and industries in Alberta. Branch personnel provide to the industry counselling services in the areas of manufacturing opportunities, site location, arranging manufacturing licenses, and production/marketing techniques, sources and uses of financing, business planning, government regulations and services and market data sourcing.

2.2 Financial Programs — This section offers analytical support, project appraisal and advice directed towards satisfying the financial needs of Alberta's business community in accordance with sound business principles. Detailed negotiations are carried out with businesses requesting financial assistance from the Province. In cases where such assistance is deemed appropriate, the section oversees the implementation and monitoring of these situations. The section maintains liaison with the financial community in order to remain abreast of evolving forms of financial assistance and provides guidance to businessmen on how to use these services.

3. **Alberta Consumer and Corporate Affairs**

3.1 Alberta Securities Commission — The Commission publishes a series of booklets designed to introduce Albertans to the investment process, advising them at the same time of the risks involved. Publications include the following:

A Guide to Franchising
How to Invest in Canadian Securities
New Deal for Old Shares
Check Before You Buy: A Guide to Buying Shares, Stocks, Bonds, and Securities in Alberta